

**Dinsmore & Shohl** LLP  
ATTORNEYS

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RECEIVED

OCT 29 2007

PUBLIC SERVICE  
COMMISSION

October 29, 2007

**VIA HAND-DELIVERY**

Hon. Beth O'Donnell  
Executive Director  
Public Service Commission  
211 Sower Blvd.  
Frankfort, KY 40601

***Re: Application of Kentucky-American Water Company, a/k/a Kentucky American Water for Certificate of Convenience and Public Necessity Authorizing Construction of Kentucky River Station II ("KRS II"), Associated Facilities, and Transmission Line; Case No. 2007-00134***

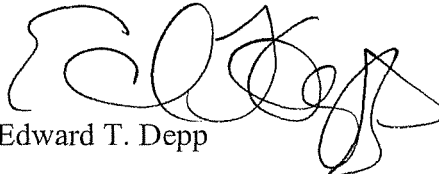
Dear Ms. O'Donnell:

We have enclosed, for filing with the Public Service Commission of the Commonwealth of Kentucky ("Commission"), an original and ten (10) copies, of the Louisville Water Company's Responses to The Attorney General's Supplemental Data Requests.

Thank you, and if you have any questions, please call us.

Very truly yours,

**DINSMORE & SHOHL LLP**



Edward T. Depp

ETD/bmt  
Enclosures

cc: All Parties of Record (w/enclosures)  
Barbara K. Dickens, Esq. (w/enclosures)  
John E. Selent, Esq. (w/o enclosures)

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**COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION**

**IN THE MATTER OF:**

**THE APPLICATION OF KENTUCKY-AMERICAN  
WATER COMPANY FOR A CERTIFICATE OF  
CONVENIENCE AND NECESSITY AUTHORIZING  
THE CONSTRUCTION OF KENTUCKY RIVER  
STATION II, ASSOCIATED FACILITIES AND  
TRANSMISSION MAIN**

**CASE NO. 2007-00134**

**RECEIVED**

**OCT 29 2007**

**PUBLIC SERVICE  
COMMISSION**

**LOUISVILLE WATER COMPANY'S RESPONSES TO THE  
ATTORNEY GENERAL'S SUPPLEMENTAL DATA REQUESTS**

For its responses to the supplemental data requests of the Attorney General of the Commonwealth of Kentucky ("AG"), Louisville Water Company ("LWC"), by counsel hereby states as follows.

**REQUESTS FOR INFORMATION**

1. Please provide the electronic spreadsheet files, with all formulas and links intact, used to produce the appendices to the R.W. Beck report attached to Mr. Wetzel's testimony.

**Responsible Witness: Ed Wetzel**

**RESPONSE:** Please refer to the electronic version of the R. W. Beck study LWC has produced as a supplement to its open records response.

2. Please provide the electronic spreadsheet files, with all formulas and links intact, used to produce the graphs in the R.W. Beck report attached to Mr. Wetzel's testimony.

**Responsible Witness: Ed Wetzel**

**RESPONSE:** Please refer to the electronic version of the R. W. Beck study LWC has produced as a supplement to its open records response.

3. Please provide an analysis similar to that contained in the R.W. Beck report for the proposal contained in the rebuttal testimony of Mr. Heitzman (pp. 4-7).

**Responsible Witness: Ed Wetzel**

**RESPONSE:** At the request of LWC, R. W. Beck is conducting such an analysis. Upon completion, this additional analysis will be made available to the Commission and all parties no later than Friday, November 9, 2007.

4. Please provide an explanation and all supporting documents for the following assumptions used in the R.W. Beck report attached to Mr. Wetzel's testimony:

a. Construction inflation rate of 3%;

**Responsible Witness: Ed Wetzel**

**RESPONSE:** This rate was based on the Engineering News Record Construction Cost Index from July of 2006 to July of 2007, attached hereto.

b. Municipal bond interest rate of 4.7%;

**Responsible Witness: Ed Wetzel**

**RESPONSE:** This rate was based on the Merrill Lynch Muni Master Yield index of municipal bond yields as published in the Wall Street Journal in July of 2007, attached hereto.

c. KAW interest rate on debt of 6.5%;

**Responsible Witness: Ed Wetzel**

**RESPONSE:** This rate, used to estimate capitalized interest costs, was based on Appendix B (Financing Alternatives for Ky River Pool #3 Project) to the Water Supply Study prepared for KAWC by Gannett Fleming, Inc. in March of 2007. R. W. Beck also conducted an analysis of recent interest rates supporting a marginal cost of borrowing of 6.5%. Please see the attached document showing that average.

d. KAW return on rate base of 7.75%;

**Responsible Witness: Ed Wetzel**

**RESPONSE:** KAWC is allowed a before tax return on rate base of 7.75% based on Kentucky Public Service Commission Case No. 2004-00103.

e. Annual increase in wholesale rate of 3%;

**Responsible Witness: Ed Wetzel**

**RESPONSE:** This rate of increase was conservatively based on the twenty year historical average increase of 2.28% in wholesale rates for LWC. Please also refer to the response to KAWC Supplemental Request No. 39.

f. O&M expense inflation rate of 2.4%; and

**Responsible Witness: Ed Wetzel**

**RESPONSE:** This rate was based on the Blue Chip Economic Indicators long term view on inflation published in March of 2007, attached hereto.

g. Discount rate of 4.7%.

**Responsible Witness: Ed Wetzel**

**RESPONSE:** This rate was based on the Merrill Lynch Muni Master Yield index of municipal bond yields as published in the Wall Street Journal in July of 2007, attached hereto.

5. Other than the analysis that examined different escalation rates in LWC's charges, did Mr. Wetzel or anyone under his direction at R.W. Beck perform any sensitivity analyses of either the LWC or KAW cases? If so, please describe each such sensitivity analysis and provide the output of each such analysis. If it is not readily apparent, please list the cells in the electronic spreadsheet files that are varied for producing each sensitivity analysis. If no such sensitivity analyses were performed, please explain why not.

**Responsible Witness: Ed Wetzel**

**RESPONSE:** No additional sensitivity analyses were conducted. In R.W. Beck's judgment, the other input variables to the model are economic factors that are not independent of one another. For example, if the rate of inflation over the next 20 to 40 years turns out to differ from the 2.4% assumed in the model, it will likely impact most, if not all, of the other economic variables.

6. On page 6-2 of the R.W. Beck report attached to Mr. Wetzel's testimony, it states: "The capital costs are significantly lower ..." Concerning this:

- a. Please define the term "significantly" as used here and provide the analysis performed to determine that the difference was significant.

**Responsible Witness: Ed Wetzel**

**RESPONSE:** The statement referenced above refers to Table 6-1 on page 6-1, in which the capital costs for the LWC pipeline options were shown to be from 32% to 51% lower than the Pool 3 option. R.W. Beck believes this difference can be described as significant.

In the revised R. W. Beck study, these percentages remain the same.

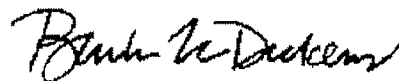
- b. The report states that there is a significant difference in capital costs, but it does not use the same term when describing differences in the total life-cycle costs. In Mr. Wetzel's opinion, is there is a significant difference in total life-cycle costs between the LWC and KAW options? If so, provide the analysis performed to determine that the difference was significant. If not, please explain why not.

**Responsible Witness: Ed Wetzel**

**RESPONSE:** R.W. Beck believes there is also a significant difference between the present worth costs. Table 6-2 on page 6-2 of the originally filed R. W. Beck study indicated that these differences ranged from 9% to 41%.

In the revised R. W. Beck study, at Table 6-2 on page 6-2, R. W. Beck determined that the present worth costs differences in the KAWC Pool 3 option and the Louisville Pipeline ranged from 26% to 43%. As before, R. W. Beck believes this difference can be described as significant.

Respectfully submitted,



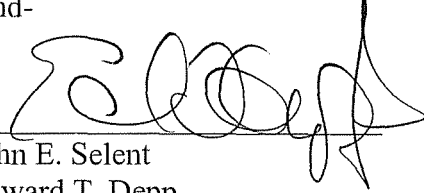
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Vice President and General Counsel  
Louisville Water Company  
550 South Third Street



Louisville, KY 40202  
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-and-

A handwritten signature in black ink, appearing to read 'John E. Selent', written over a horizontal line.

John E. Selent  
Edward T. Depp  
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1400 PNC Plaza  
500 West Jefferson Street  
Louisville, KY 40202  
tel: (502) 540-2300  
fax: (502) 585-2207

*Counsel to Louisville Water Company*

### **CERTIFICATION**

I hereby certify that I have supervised the preparation of Louisville Water Company's responses to the supplemental data requests of the Attorney General and that the responses contained herein (and for which I am designated the responsible witness) are true and accurate to the best of my knowledge, information, and belief formed after reasonable inquiry.

\_\_\_\_\_  
Edward Wetzel,  
Executive Vice President of R. W. Beck

Date: \_\_\_\_\_

**CERTIFICATE OF SERVICE**

I hereby certify that a copy of the foregoing was served by was served via first-class United States mail, sufficient postage prepaid, on the following individuals this 29th day of October, 2007:

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*Counsel to Louisville Water Company*

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## Cost Indexes



### Construction Cost Index

With the labor cost component holding steady, a 0.2% decrease in materials costs was able to pull the CCI down.

20-CITY: 1913=100	JUNE 2007 INDEX VALUE	% CHG. MONTH	% CHG. YEAR
CONSTRUCTION COST	7938.58	-0.1	+3.1
COMMON LABOR	16693.95	0.0	+4.0
WAGE \$/HR.	31.72	0.0	+4.0

### Building Cost Index

The BCI followed the CCI's trend with a slight decline in the materials costs and no change in labor costs.



20-CITY: 1913=100	JUNE 2007 INDEX VALUE	% CHG. MONTH	% CHG. YEAR
BUILDING COST	4471.23	-0.1	+3.0
SKILLED LABOR	7579.13	0.0	+5.1
WAGE \$/HR.	42.06	0.0	+5.1

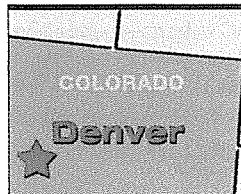


### Materials Cost Index

A 1% decline in lumber prices was enough to offset increases of 0.2% for cement and 0.1% for steel.

20-CITY: 1913=100	JUNE 2007 INDEX VALUE	% CHG. MONTH	% CHG. YEAR
MATERIALS	2572.39	-0.2	-0.5
CEMENT S/TON	99.66	+0.2	+6.5
STEEL S/CWT	40.32	+0.1	+7.0
LUMBER S/MBF	436.08	-1.0	-14.5

## Muted Decline in Lumber Prices Cushions Index



Construction costs in the Mile High City are escalating at a slightly faster pace than the national average. Denver's CCI for June was up 3.7% from a year ago, compared to a 3.1% increase for the 20-city average CCI. Lumber prices in the Denver index are down only 6.4% for the year, compared to a 15% decline for the national average. Cement prices in Denver are up 6.7% over June 2006's level.

### Cost Indexes by City

1913=100 CITY	CONSTRUCTION COST JUNE '07 INDEX	% CHG. YEAR	BUILDING COST JUNE '07 INDEX	% CHG. YEAR	COMMON LABOR JUNE '07 INDEX	% CHG. YEAR	SKILLED LABOR JUNE '07 INDEX	% CHG. YEAR	MATERIALS JUNE '07 INDEX	% CHG. YEAR
ATLANTA	5264.94	+9.2	3631.21	+1.2	9707.89	+14.1	5415.62	+2.6	2541.84	-0.7
BALTIMORE	5407.88	-1.1	4054.18	+3.0	10105.26	0.0	6551.35	+7.7	2528.84	-3.7
BIRMINGHAM	5492.62	-2.2	3284.88	-3.6	10621.05	0.0	4817.42	0.0	2349.39	-7.7
BOSTON	9761.54	+6.0	5377.50	+7.8	21697.37	+6.4	10173.57	+9.3	2446.03	+4.1
CHICAGO	10522.81	+4.0	5367.52	+5.1	23257.89	+4.1	9703.90	+6.0	2717.43	+3.2
CINCINNATI	7434.16	+0.3	3916.71	-2.7	15534.21	+2.6	6285.89	+1.1	2469.61	-7.9
CLEVELAND	8531.18	+7.7	4377.46	+4.8	18534.21	+9.7	7613.21	+8.1	2400.29	-1.0
DALLAS	5008.56	+6.5	3513.95	+10.1	8700.00	+6.8	4772.97	+14.4	2746.06	+5.9
DENVER	5767.64	+3.7	3765.50	+2.5	10831.58	+4.3	5569.97	+2.8	2663.94	+2.2
DETROIT	8832.51	+1.3	4780.90	-1.5	19268.42	+3.2	8617.42	+1.4	2436.31	-7.3
KANSAS CITY	8717.92	+2.6	4742.42	+6.6	18215.79	+3.0	7763.96	+10.1	2896.65	+1.3
LOS ANGELES	8854.77	+3.6	4704.15	+7.0	19026.32	+4.0	8114.11	+9.9	2620.60	+2.0
MINNEAPOLIS	9106.88	+1.1	4558.55	-1.8	20126.32	+3.9	8167.57	+3.4	2353.03	-11.2
NEW ORLEANS	4582.14	+2.7	3287.85	+1.6	7763.16	+3.1	4362.76	+1.2	2632.49	+2.0
NEW YORK	12436.62	+3.1	6568.28	+3.3	28139.47	+3.1	12712.91	+3.1	2812.28	+3.7
PHILADELPHIA	9629.48	+4.5	5306.10	+5.6	21105.26	+4.4	9740.54	+5.8	2595.94	+4.9
PITTSBURGH	7361.57	+1.0	4329.62	+1.7	14997.37	0.0	7027.63	0.0	2681.56	+4.6
ST. LOUIS	8369.28	-1.1	4269.05	-1.3	18257.89	0.0	7477.48	+1.5	2308.52	-6.3
SAN FRANCISCO	9063.41	+7.4	4980.14	+4.0	19621.05	+8.9	8887.09	+5.6	2592.60	+0.7
SEATTLE	8625.67	+2.0	4608.58	+5.6	18368.42	+1.9	7807.21	+7.5	2654.31	+2.5
MONTREAL	8334.89	+3.0	4620.72	-0.7	17131.58	+5.6	7366.97	+2.6	2943.37	-5.3
TORONTO	9319.71	+0.6	4820.32	+1.1	19373.68	0.0	7542.94	0.0	3157.59	+2.8

## Sewer, Water and Drain Pipe

ITEM	UNIT	ATLANTA	BALTIMORE	BIRMINGHAM	BOSTON	CHICAGO	CINCINNATI	CLEVELAND	DALLAS	DENVER	DETROIT	KANSAS CITY
<b>REINFORCED CONCRETE PIPE (RCP):</b>												
12"	ft	11.04	29.10	10.76	+9.11	10.15	9.90	8.40	-12.65	11.77	12.10	11.80
24"	ft	28.92	47.95	25.17	+21.82	+22.07	21.50	20.00	-27.50	21.08	36.55	+29.50
36"	ft	49.10	95.00	50.82	+47.95	+43.15	49.95	44.00	-56.00	49.98	74.75	+62.30
48"	ft	79.70	158.15	82.93	+72.63	68.30	82.10	72.00	-85.10	77.30	112.45	+98.20
<b>CORRUGATED STEEL PIPE:</b>												
12"	ft	8.38	8.63	7.57	8.34	8.70	7.31	8.70	8.04	7.54	6.00	10.26
36"	ft	23.40	25.14	23.68	27.38	20.58	22.30	19.85	23.78	24.80	28.23	28.69
60"	ft	53.12	51.67	48.50	63.89	+76.70	54.60	54.00	68.00	65.22	81.80	77.92
<b>VITRIFIED CLAY PIPE (VCP): PREMIUM JOINT</b>												
12"	ft	—	—	—	—	—	—	15.60	—	—	11.43	7.60
24"	ft	—	—	—	—	—	—	85.00	—	—	38.56	33.39
<b>POLYETHYLENE PIPE (PE): UNDERDRAIN</b>												
4"	ft	1.24	—	0.43	0.80	2.07	0.51	0.88	1.30	1.23	0.48	—
<b>POLYVINYLCHLORIDE PIPE (PVC): SEWER</b>												
4"	ft	1.92	+2.75	1.90	1.59	2.52	-1.08	1.40	+2.19	1.98	1.58	1.50
8"	ft	+5.44	3.82	7.64	4.48	7.70	+4.23	5.47	4.39	7.72	4.33	4.85
Water 6"	ft	+5.70	1.86	-4.26	6.20	+8.50	+4.23	4.97	5.12	+6.05	6.23	2.53
8"	ft	9.20	+3.40	-7.64	10.59	8.89	+6.99	7.15	8.28	+9.25	11.78	4.55
12"	ft	+18.04	+7.65	+17.21	21.97	19.04	+14.64	15.05	-14.04	+15.56	23.48	11.10
<b>DUCTILE IRON PIPE (DIP):</b>												
6"	ft	10.28	+12.31	8.54	12.84	13.25	13.00	11.98	12.98	9.70	15.58	-9.15
8"	ft	14.95	+33.15	11.40	17.02	16.70	25.68	16.58	18.12	15.28	21.26	-12.70
12"	ft	23.83	53.94	18.89	27.20	29.04	29.90	26.28	29.80	25.75	34.69	-21.45
<b>COPPER WATER TUBING: TYPE L</b>												
1/2"	ft	2.25	1.61	1.82	1.70	2.07	1.61	2.23	2.28	+1.65	2.82	3.29
1 1/2"	ft	3.21	4.90	4.85	5.38	4.59	4.90	6.18	4.92	+3.60	3.78	11.22

+ or - denotes price has risen or fallen since previous report; a=feet, includes federal tax; b=meters, excludes tax; c=1.5 meters. Monthly market quotations by ENR field reporters as of June 4, 2007. All prices are spot prices quoted from a single source. Quotes are delivered prices unless noted. Some prices may include taxes or discounts for prompt payment, etc. Product specification may vary, depending on what is most commonly used or most accessible in a city. All quantities are truckloads unless noted. Quotes for Montreal and Toronto are in Canadian dollars and a mix of metric and American units. RCP pipe is ASTM C76; 12 in. and 24 in. are rubber-gasket jointed; others are non-jointed. (continued on p. 26)





IN T

# Debt Investors Grow Decided

BY MICHAEL ANEIRO

If debt financing packages getting pulled is enough to make a prospective borrower flinch, companies and underwriters would do well to avert their eyes from the secondary market where existing debt is traded.

The wave of selling slamming high-yield markets could embolden investors to ask for even higher risk premiums and stiffer protective clauses, making financing more expensive and the original rationale for leveraged buyouts less compelling.

## CREDIT MARKETS

Already, debt investors, who

have gone from passive to decidedly discriminating, have forced several would-be issuers to postpone offerings, often indefinitely. Yesterday, bankers postponed the sale of \$12 billion in loans to fund Cerberus's purchase of Chrysler's auto operations and Alliance Boots put a portion of its financing package on hold.

Many prospective borrowers—the majority of which are drumming up money for their respective LBOs—hope conditions will improve by the time they tap the market later in the year, but market participants say that's far from certain.

In less than two months, risk premiums on cash high-yield

bonds have rocketed more than 100 basis points, or hundred of a percentage point, from their historic low of 2.25 percent on June 5, according to the Merrill Lynch High-Yield Master Index. In the past week alone, spreads have risen from 30 basis points to 361 basis points, and Treasuries. Valuations in the market have also slumped.

In a sign that investor appetite is growing, buyers and sellers are having a hard time agreeing on a price for a bond. The bid-ask spread, known as the bid-ask spread, grew so large as to inhibit trading yesterday.

"I wouldn't say that cre-

to ance showed higher delinquencies and defaults.

The BBB-slice of the index was quoted at 39 cents on the dollar before bouncing back to 41.79 cents by late afternoon, according to data from Markit Group, the administrator of the index. Its counterpart in the current index, based on loans made in the first half of this year, was quoted at 47.31 cents, according to Markit.

—Anusha Shrivastava

## BONDS

### Tracking Bond Benchmarks

Return on investment and spreads over Treasuries and/or yields paid to investors compared with 52-week highs and lows for different types of bonds

Total return close	YTD total return (%)	Index	Latest	Low	0	YIELD (%), 52-WEEK RANGE	Latest	High
1211.16	1.5%	Broad market Lehman Aggregate	5.640	5.080		3 6 9 12 15	5.850	
1518.61	1.1	U.S. Corporate Lehman Brothers	6.000	5.390			6.200	
1544.93	1.7	Intermediate	5.810	5.210			6.010	
1732.56	-0.7%	Long term	6.540	5.290			6.730	
320.03		Double-A-rated	5.680	5.071			5.920	
324.80		Triple-B-rated	6.320	5.700			6.460	
191.23	1.0	High Yield Constrained Merrill Lynch	8.610	7.380			8.610	
175.19	2.3	Triple-C-rated	10.974	9.243			11.290	
1554.35	0.7	High Yield 100	8.200	6.865			8.200	
168.42	0.9	Global High Yield Constrained	8.431	7.239			8.431	
140.89	-0.2	Europe High Yield Constrained	7.344	6.036			7.344	
1140.32	1.9	U.S. Agency Lehman	5.330	4.825			5.560	
1056.08	2.2	10-20 years	5.300	4.805			5.520	
1646.52	-0.6	20-plus years	5.720	5.021			5.970	
1253.75	1.3	Mortgage-Backed Lehman	6.040	5.400			6.190	
1234.60	1.3	Ginnie Mae (GNMA)	6.060	5.433			6.210	
719.52	1.2	Fannie mae (FNMA)	6.030	5.385			6.180	
1127.11	1.3	Freddie Mae (FHLMC)	6.050	5.406			6.200	
335.63	0.9	Muni Master Merrill Lynch	4.145	3.730			4.293	
220.63	0.6	7-12 year	4.106	3.670			4.256	
240.77	0.5	12-22 year	4.406	3.940			4.562	
235.84	0.2	22-plus year	4.689	4.119			4.785	
1454.17	1.7	Yankee Lehman	5.660	5.200			5.890	
361.86	0.1	Global Government J.P. Morgan	3.870	3.343			4.050	
494.21	-0.8	Canada	4.550	3.901			4.680	
225.89	-0.6	EMU	4.560	3.780			4.790	
424.55	-0.7	France	4.490	3.705			4.730	
319.13	-0.3	Germany	4.450	3.699			4.700	
223.18	-0.2	Japan	1.780	1.488			1.870	
341.20	-0.4	Netherlands	4.500	3.694			4.730	
483.56	-1.2	U.K.	4.910	4.208			5.160	
387.35	0.7	Emerging Markets **	6.954	6.336				

\* Constrained indexes limit individual issuer exposure.

## Pension Investor Targets Mackey

CHICAGO—An investment group affiliated with union pension funds said John Mackey, the chief executive of Whole Foods Market Inc., should step down as chairman of the natural-foods giant in the wake of disclosures that he posted anonymous comments on Internet stock-market forums.

Citigroup Investment Group, a branch of Change to Win, a coalition of labor unions, urged the board to name an independent chairman "who can quickly establish credibility with regulatory authorities and shareholders." A Whole Foods spokeswoman declined to comment.

## MARKS

July 25, 2007

International markets. Rates below are a guide

WEEK —	Latest	Week ago	— 52-WEEK —	Low
Low			High	
London interbank offered rate, or Libor				
One month	5.32000	5.32000	5.42000	5.31913
Three month	5.36000	5.36000	5.50000	5.33000
Six month	5.37031	5.38250	5.57188	5.25913
One year	5.36000	5.41125	5.63813	5.11000
Euro Libor				
One month	4.106	4.104	4.120	2.993
Three month	4.239	4.220	4.239	3.141
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Euro interbank offered rate (Euribor)				
One month	4.104	4.103	4.119	2.992
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One year	4.564	4.583	4.594	3.534
Hibor				



Louisville Technical Analysis

LWC 2030 Option

Comparison of Various Interest Rates

Month	Bank Prime Loan	10-Year		20-Year		State and Local Bonds		Aaa Moody's Seasoned Corporate Bonds		Baa Moody's Seasoned Corporate Bonds	
		Treasury Constant Maturities	Treasury Constant Maturities	Treasury Constant Maturities	Treasury Constant Maturities	State and Local Bonds	State and Local Bonds	Aaa Moody's Seasoned Corporate Bonds	Aaa Moody's Seasoned Corporate Bonds	Baa Moody's Seasoned Corporate Bonds	Baa Moody's Seasoned Corporate Bonds
October 2005	6.75%	4.46%	4.46%	4.74%	4.74%	4.48%	4.48%	5.35%	5.35%	6.39%	6.39%
November 2005	7.00%	4.54%	4.54%	4.83%	4.83%	4.57%	4.57%	5.42%	5.42%	6.32%	6.32%
December 2005	7.15%	4.47%	4.47%	4.73%	4.73%	4.46%	4.46%	5.37%	5.37%	6.24%	6.24%
January 2006	7.26%	4.42%	4.42%	4.65%	4.65%	4.37%	4.37%	5.29%	5.29%	6.24%	6.24%
February 2006	7.50%	4.57%	4.57%	4.73%	4.73%	4.41%	4.41%	5.35%	5.35%	6.27%	6.27%
March 2006	7.53%	4.72%	4.72%	4.91%	4.91%	4.44%	4.44%	5.53%	5.53%	6.41%	6.41%
April 2006	7.75%	4.99%	4.99%	5.22%	5.22%	4.58%	4.58%	5.84%	5.84%	6.68%	6.68%
May 2006	7.93%	5.11%	5.11%	5.35%	5.35%	4.59%	4.59%	5.95%	5.95%	6.75%	6.75%
June 2006	8.02%	5.11%	5.11%	5.29%	5.29%	4.60%	4.60%	5.89%	5.89%	6.78%	6.78%
July 2006	8.25%	5.90%	5.90%	5.25%	5.25%	4.61%	4.61%	5.85%	5.85%	6.76%	6.76%
August 2006	8.25%	4.88%	4.88%	5.08%	5.08%	4.39%	4.39%	5.68%	5.68%	6.59%	6.59%
September 2006	8.25%	4.72%	4.72%	4.93%	4.93%	4.27%	4.27%	5.51%	5.51%	6.43%	6.43%
October 2006	8.25%	4.73%	4.73%	4.94%	4.94%	4.30%	4.30%	5.51%	5.51%	6.42%	6.42%
November 2006	8.25%	4.60%	4.60%	4.78%	4.78%	4.14%	4.14%	5.51%	5.51%	6.20%	6.20%
December 2006	8.25%	4.56%	4.56%	4.78%	4.78%	4.11%	4.11%	5.33%	5.33%	6.22%	6.22%
January 2007	8.25%	4.76%	4.76%	4.95%	4.95%	4.23%	4.23%	5.32%	5.32%	6.34%	6.34%
February 2007	8.25%	4.72%	4.72%	4.93%	4.93%	4.22%	4.22%	5.40%	5.40%	6.28%	6.28%
March 2007	8.25%	4.56%	4.56%	4.81%	4.81%	4.15%	4.15%	5.39%	5.39%	6.27%	6.27%
April 2007	8.25%	4.69%	4.69%	4.95%	4.95%	4.26%	4.26%	5.30%	5.30%	6.39%	6.39%
May 2007	8.25%	4.75%	4.75%	4.98%	4.98%	4.31%	4.31%	5.47%	5.47%	6.39%	6.39%
June 2007	8.25%	5.10%	5.10%	5.29%	5.29%	4.60%	4.60%	5.79%	5.79%	6.70%	6.70%
July 2007	8.25%	5.00%	5.00%	4.19%	4.19%	4.56%	4.56%	5.73%	5.73%	6.65%	6.65%
August 2007	8.25%	4.67%	4.67%	5.00%	5.00%	4.64%	4.64%	5.79%	5.79%	6.65%	6.65%
September 2007	8.03%	4.52%	4.52%	4.84%	4.84%	4.51%	4.51%	5.74%	5.74%	6.59%	6.59%
24-Month Average	7.93%	4.77%	4.77%	4.92%	4.92%	4.41%	4.41%	5.55%	5.55%	6.46%	6.46%
12-Month Average	8.23%	4.72%	4.72%	4.87%	4.87%	4.34%	4.34%	5.52%	5.52%	6.43%	6.43%
6-Month Average	8.21%	4.79%	4.79%	4.88%	4.88%	4.48%	4.48%	5.64%	5.64%	6.56%	6.56%
6-Mo Avg + 100 Basis points										7.56%	7.56%

- Average

Source: Federal Reserve Statistical Release, Bulletin H.1.5.



# MEMORANDUM



To: Distribution List

From: Richard Cuthbert

Subject: **Blue Chip Economic Indicator Projections**

Date: October 23, 2006

Attached is a summary of financial projections from the October 10, 2006 *Blue Chip Economic Indicators (BCEI)*. The attached sheet provides both short-term and long-term projections through the year 2017 for the gross domestic product (GDP) chained price index, the consumer price index (CPI), and average yields on 3-Month Treasury Bills and 10-Year Treasury Notes. Two graphs are included which compare historical and projected changes in inflation and overall growth of the U.S. economy as measured by the CPI and the Real GDP Index (Chained), and also show changes in projections for these two indicators from prior *BCEI* publications.

The current forecast indicates a higher level of projected inflation for 2006 than anticipated earlier in the year (now 3.5% for the CPI and 3.1% for the GDP Price Index), but long-term inflationary projections are estimated to be lower for 2007 and beyond. Immediate inflationary concerns have diminished as energy prices and long-term interest rates have declined in the past few months. The projected average long-term rates of inflation, at approximately 2.4% annually for the CPI and at 2.1% annually for the GDP Price Index for 2007 to 2017, reflect the moderately low inflation levels witnessed during the last decade.

Interest rates are projected to remain at near current levels through 2007 and long-term projections range from 4.5% to 4.8% for 3-Month Treasury rates and 4.9% to 5.3% for 10-Year Treasury rates. The *BCEI* reports that the Federal Reserve may be cautious about lowering interest rates in 2007 and decreasing long-term interest rates due to increases in economic growth (resulting from a positive outlook for the housing and automotive sectors) and elevated levels of inflation in recent times. Overall current projections assume healthy economic growth of real GDP averaging about 3.0% per year from 2007 through 2017.

This memorandum is updated twice each year, but monthly data is also available. For information on updated data, please contact Gina Baxter at (206) 695-4768. Also, the firm maintains on-line Internet access to numerous data series and projections. Please feel free to contact myself or one of the other economists in the firm if you need additional information.

RWC:  
Attachments

## Economic Projections (Summarized from "Blue Chip Economic Indicators")

**SHORT-TERM PROJECTIONS:**      October 10, 2006

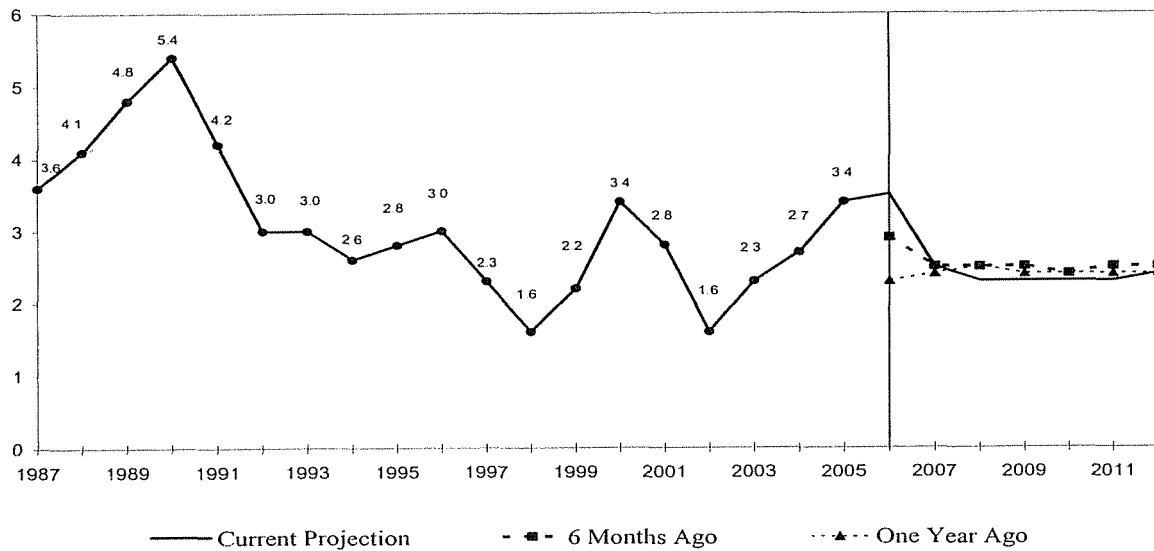
<i>Blue Chip Consensus Annual Projections:</i>		<i>Percent Change Over Prior Year</i>							
		2006				2007			
		<u>Average</u>	<u>6-months Ago</u>	<u>Top 10</u>	<u>Bottom 10</u>	<u>Average</u>	<u>6-months Ago</u>	<u>Top 10</u>	<u>Bottom 10</u>
GDP Price Index		3.1	2.6	3.2	2.9	2.4	2.2	2.9	2.0
CPI		3.5	2.9	3.7	3.3	2.5	2.4	3.1	2.1
		<i>Average for Year</i>							
		2006				2007			
		<u>Average</u>	<u>6-months Ago</u>	<u>Top 10</u>	<u>Bottom 10</u>	<u>Average</u>	<u>6-months Ago</u>	<u>Top 10</u>	<u>Bottom 10</u>
Treasury Bills - 3-month		4.8	4.7	5.0	4.7	4.8	4.7	5.2	4.3
Treasury Notes - 10-year		4.8	4.8	5.0	4.8	4.9	5.0	5.4	4.5
<i>Blue Chip Consensus Quarterly Projections:</i>		<i>% Change from Prior Quarter *</i>				<i>Average Yield for Quarter *</i>			
		GDP Price				3-month 10-year			
		<u>Index</u>		<u>CPI</u>		<u>T-Bills</u>		<u>T-Notes</u>	
<u>2005</u>	1st Quarter Actual		3.5		2.3		2.5		4.3
	2nd Quarter Actual		2.4		3.8		2.9		4.2
	3rd Quarter Actual		3.3		5.5		3.4		4.2
	4th Quarter Actual		3.3		3.3		3.8		4.5
<u>2006</u>	1st Quarter Actual		3.3		2.2		4.4		4.6
	2nd Quarter Actual		3.3		4.9		4.7		5.1
	3rd Quarter Forecast		2.6		3.2		4.9		4.9
	4th Quarter Forecast		2.2		1.7		5.0		4.9
<u>2007</u>	1st Quarter Forecast		2.5		2.7		4.9		4.9
	2nd Quarter Forecast		2.3		2.5		4.9		4.9
	3rd Quarter Forecast		2.2		2.3		4.8		4.9
	4th Quarter Forecast		2.2		2.3		4.7		5.0

\* Note - Figures represent annualized % change from prior quarter. Use quarterly information with care; estimates are subject to revisions, e

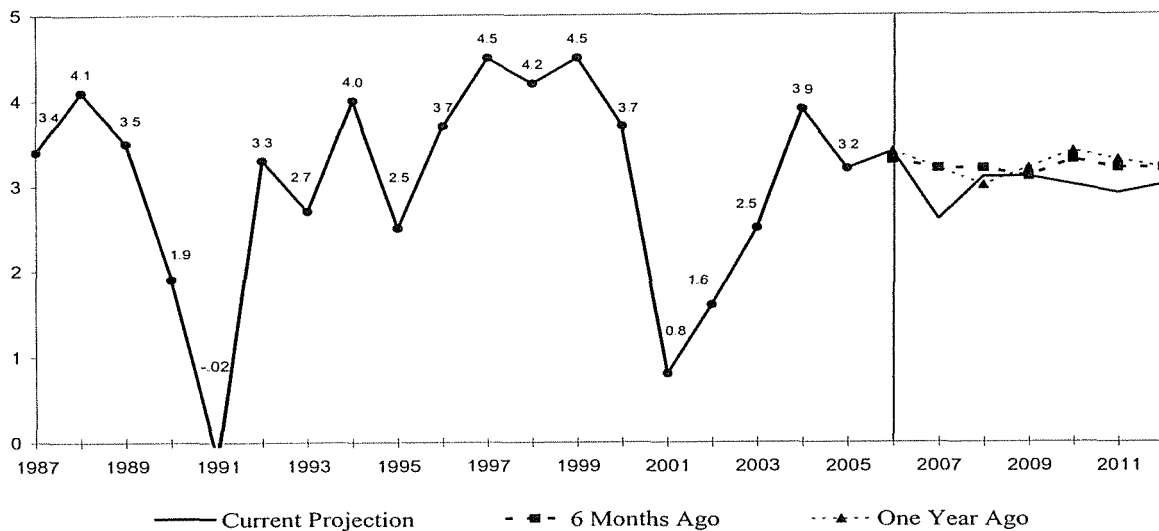
**LONG-TERM PROJECTIONS:**      October 10, 2006

	<i>Percent Change from Prior Year's Annual Rate</i>						<i>Annual Rates</i>	
							2008 -	2007 -
	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>		<u>2012</u>	<u>2017</u>
<u>GDP Price Index</u>								
Blue Chip Consensus	2.1	2.1	2.1	2.1	2.1		2.1	2.1
Consensus - Six Months Ago	2.1	2.1	2.1	2.1	2.1		2.1	2.1
Top 10 Average	2.6	2.6	2.5	2.5	2.5		2.5	2.6
Bottom 10 Average	1.6	1.7	1.7	1.7	1.7		1.7	1.7
<u>Consumer Price Index (CPI)</u>								
Blue Chip Consensus	2.3	2.3	2.3	2.3	2.4		2.3	2.4
Consensus - Six Months Ago	2.3	2.3	2.3	2.3	2.3		2.3	2.4
Top 10 Average	2.8	2.8	2.7	2.7	2.7		2.7	2.8
Bottom 10 Average	1.8	1.8	1.8	1.9	2.0		1.9	1.9
<i>Annual Average</i>							2008 -	2007 -
							<u>2012</u>	<u>2017</u>
<u>Treasury Bills - 3-month</u>								
Blue Chip Consensus	4.6	4.7	4.5	4.5	4.6		4.6	4.6
Consensus - Six Months Ago	4.7	4.7	4.7	4.5	4.6		4.6	4.6
Top 10 Average	5.1	5.3	5.0	5.0	5.1		5.1	5.1
Bottom 10 Average	4.0	4.0	3.9	4.0	4.1		4.0	4.0
<u>Treasury Notes - 10-Year</u>								
Blue Chip Consensus	5.2	5.2	5.2	5.2	5.3		5.2	5.2
Consensus - Six Months Ago	5.4	5.5	5.5	5.4	5.5		5.5	5.4
Top 10 Average	5.6	5.7	5.7	5.7	5.9		5.7	5.7
Bottom 10 Average	4.7	4.8	4.7	4.8	4.8		4.8	4.8

**Historical and Projected Inflation  
as Measured by Annual Change of the  
Consumer Price Index (CPI)  
Blue Chip Economic Indicators: October 2006**



**Historical and Projected Economic Growth  
as Measured by Annual Change in Real GDP (Chained)  
Blue Chip Economic Indicators: October 2006**







# Debt Investors Grow Decided

By MICHAEL ANEIRO

If debt financing packages getting pulled is enough to make a prospective borrower flinch, companies and underwriters would do well to avert their eyes from the secondary market where existing debt is traded.

The wave of selling slamming high-yield markets could embolden investors to ask for even higher risk premiums and stiffer protective clauses, making financing more expensive and the original rationale for leveraged buyouts less compelling.

Already, debt investors, who

have gone from passive to decidedly discriminating, have forced several would-be issuers to postpone offerings, often indefinitely. Yesterday, bankers postponed the sale of \$12 billion in loans to fund Cerberus's purchase of Chrysler's auto operations and Alliance Boots put a portion of its financing package on hold.

Many prospective borrowers—the majority of which are drumming up money for their respective LBOs—hope conditions will improve by the time they tap the market later in the year, but market participants say that's far from certain.

In less than two months, risk premiums on cash high-yield

bonds have rocketed more than 100 basis points, or hundredths of a percentage point, from their historic low of 2.25 percent over Treasury yields on June 5, according to the Merrill Lynch High-Yield Master Index. In the past week alone, spreads have risen from 30 basis points to 361 basis points over Treasuries. Valuations in the high-yield market have also slumped.

In a sign that investor appetite is growing, buyers and sellers are having a hard time agreeing on a price for a bond. The bid-ask spread, known as the bid-ask spread, grew so large as to inhibit trading yesterday.

"I wouldn't say that cre-

ance showed higher delinquencies and defaults.

The BBB-slice of the index was quoted at 39 cents on the dollar before bouncing back to 41.79 cents by late afternoon, according to data from Markit Group, the administrator of the index. Its counterpart in the current index, based on loans made in the first half of this year, was quoted at 47.31 cents, according to Markit.

—Anusha Shrivastava

## Pension Investor Targets Mackey

CHICAGO—An investment group affiliated with union pension funds said John Mackey, the chief executive of Whole Foods Market Inc., should step down as chairman of the natural-foods giant in the wake of disclosures that he posted anonymous comments on Internet stock-market forums.

CtW Investment Group, a branch of Change to Win, a coalition of labor unions, urged the board to name an independent chairman "who can quickly establish credibility with regulatory authorities and shareholders."

A Whole Foods spokeswoman declined to comment.

## BONDS

### Tracking Bond Benchmarks

Return on investment and spreads over Treasuries and/or yields paid to investors compared with 52-week highs and lows for different types of bonds

Total return close	YTD total return (%)	Index	Latest	Low	0	YIELD (%)	52-WEEK RANGE	Latest	15	High
1211.16	1.5%	Broad market Lehman Aggregate	5.640	5.080						5.850
1518.61	1.1	U.S. Corporate Lehman Brothers	6.000	5.390						6.200
1544.93	1.7	Intermediate	5.810	5.210						6.010
1732.56	-0.7%	Long term	6.540	5.290						6.730
320.03	1.2	Double-A-rated	5.680	5.071						5.920
324.80	1.3	Triple-B-rated	6.320	5.700						6.460
191.23	1.0	High Yield Constrained Merrill Lynch	8.610	7.380						8.610
175.19	2.3	Triple-C-rated	10.974	9.243						11.290
1554.35	0.7	High Yield 100	8.200	6.865						8.200
168.42	0.9	Global High Yield Constrained	8.431	7.239						8.431
140.89	-0.2	Europe High Yield Constrained	7.344	6.036						7.344
1140.32	1.9	U.S. Agency Lehman	5.330	4.825						5.560
1056.08	2.2	10-20 years	5.300	4.805						5.520
1646.52	-0.6	20-plus years	5.720	5.021						5.970
1253.75	1.3	Mortgage-Backed Lehman	6.040	5.400						6.190
1234.60	1.3	Ginnie Mae (GNMA)	6.060	5.433						6.210
719.52	1.2	Fannie mae (FNMA)	6.030	5.385						6.180
1127.11	1.3	Freddie Mae (FHLMC)	6.050	5.406						6.200
335.63	0.9	Muni Master Merrill Lynch	4.145	3.730						4.293
220.63	0.6	7-12 year	4.106	3.670						4.256
240.77	0.5	12-22 year	4.406	3.940						4.562
235.84	0.2	22-plus year	4.689	4.119						4.785
1454.17	1.7	Yankee Lehman	5.660	5.200						5.890
361.86	0.1	Global Government J.P. Morgan	3.870	3.343						4.050
494.21	-0.8	Canada	4.550	3.901						4.680
225.89	-0.6	EMU	4.560	3.780						4.790
424.55	-0.7	France	4.490	3.705						4.730
319.13	-0.3	Germany	4.450	3.699						4.700
223.18	-0.2	Japan	1.780	1.488						1.870
341.20	-0.4	Netherlands	4.500	3.694						4.730
483.56	-1.2	U.K.	4.910	4.208						5.160
387.35	0.7	Emerging Markets **	6.954	6.336						

\* Constrained Indexes limit individual issuer exposure

\*\* EMU = Eurozone

## MARKS

July 25, 2007

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<b>Hibor</b>				